Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended;	)	**CC Docket No. 96-149**
	)	
and	)	
	)	
Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area	)	

REPLY COMMENTS OF AT&T CORP.

MARK C. ROSENBLUM
LEONARD J. CALI
295 North Maple Avenue
Basking Ridge, NJ 07920
(908) 221-3539

DAVID W. CARPENTER
PETER D. KEISLER
SIDLEY & AUSTIN
One First National Plaza
Chicago, Illinois 60603
(312) 853-7237

Attorneys for AT&T Corp.

August 30, 1996

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A broad array of commenters agrees with AT&T that the Commission should adopt rules under Section 272 that will, to the maximum extent possible, mitigate potential abuses by the BOCs of any residual market power they continue to possess if and when they are permitted to provide in-region interLATA services. These commenters therefore urge the Commission to adopt rules that will prohibit the BOCs from integrating their exchange and interexchange operations, and that will attempt to require the BOCs to extend the same cooperation in developing and providing services, facilities, goods, and information to unaffiliated entities as to their affiliates. The only substantive objections to these proposals comes from the RBOCs.

The RBOCs' opposition to such rules is baseless. Preliminarily, the RBOCs' contention that the rules proposed in the NPRM are either unauthorized or unnecessary is frivolous. As the agency charged with enforcing Section 272, the Commission has the statutory authority to issue regulations that reasonably interpret the statute's requirements so as to effectuate the statute's purposes -- as the Commission's proposed regulations do. The numerous disagreements with those interpretations reflected in the RBOCs' comments merely underscore the need to clarify in advance of any Section 271 application how Section 272 will be applied. In that regard, the RBOCs' suggestion that existing rules by themselves would be sufficient to curb abuses of any residual BOC market power if and when the BOCs obtain in-region interLATA authority was rejected by Congress when it enacted Sections 271 and 272, and is any event belied by years of experience.

With respect to the structural separation regulations to be adopted, the non-RBOC commenters support the Commission's conclusion that the statutory requirement that the BOC

and its affiliate "operate independently" must be given meaning, and they properly recommend that the Commission draw upon the "maximum separation" principles it developed in Computer II to enforce that requirement. The RBOCs' comments, in contrast, urge an interpretation of the structural separation requirements under which a BOC and its putatively separate affiliate would be permitted to achieve complete integration of their operations, so long as they did so through a second affiliate. In light of the RBOCs' stated intent to attempt such an strategem, it is critical that the Commission make clear in its Order that an evasion of that sort would be patently unlawful.

The RBOCs' comments on the non-discrimination rules likewise urge interpretations that would create substantial loopholes in those requirements. In particular, the suggestion that an RBOC could satisfy its non-discrimination obligation as long as it merely provides unaffiliated entities with the same services and facilities it provides to its affiliates would be a recipe for discrimination. Under that rule, a BOC could disadvantage its competitors by providing putatively identical inputs that achieve optimal performance only when used by the BOC affiliate. Similarly, the BOC could, while always honoring its affiliate's requests to develop new access arrangements, limit its competitors to requesting only those arrangements that have already been provided to that affiliate.

The RBOCs also contend that the Commission's proposed rules would foreclose their ability to engage in joint marketing. Those rules, however, would do no such thing. Their comments make clear that what the RBOCs really seek is the ability to engage in joint marketing without regard to the structural separation and equal access rules that independently apply to their conduct -- a result foreclosed by the Act.

market. In that regard, while some features of dominant carrier regulation may not be required in this context, other such features such as advance tariff review and cost support requirements -- along with the additional requirements established by Section 272 -- are necessary to deter and detect anticompetitive conduct by the BOCs and their affiliates.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to Section 1.415 of the Commission's Rules and its Notice of Proposed Rulemaking released July 18, 1996 ("NPRM"), AT&T submits these reply comments on the nonaccounting safeguards and related regulations that would apply to provision of in-region interLATA services by the Bell Operating Companies ("BOCs").[1]

A broad array of commenters agrees with AT&T that the Commission should adopt rules under Section 272 that will, to the maximum extent possible, mitigate potential abuses by the BOCs of any residual market power they continue to possess if and when they are permitted to provide in-region interLATA services. These commenters therefore urge the Commission to adopt rules that will prohibit the BOCs from integrating their exchange and interexchange operations, and that will attempt to require the BOCs to extend the same

[1] A list of the commenters, and the abbreviations used herein to refer to each, is attached as Appendix A.

cooperation in developing and providing services, facilities, goods, and information to unaffiliated entities as to their affiliates.[2]

Aside from a few state regulatory commissions that re-argue the jurisdictional issue that the Commission has already largely resolved,[3] the only entities to oppose substantial portions of the Commission's proposals are the seven Regional Bell Operating Companies and their trade association, the United States Telephone Association (collectively, "the RBOCs").[4] They contend that Congress foreclosed the adoption of such rules, and that in all events the structural separation and non-discrimination requirements of Section 272 should be construed to authorize the BOCs to integrate their exchange and interexchange operations and to withhold from competitors the kinds of cooperation that they give to their affiliates.

These Reply Comments therefore focus on the RBOCs' arguments. Part I (pp. 3 - 14) responds to the RBOCs' contention that the Commission cannot or should not adopt rules implementing Section 272. It shows that the suggestion that Congress foreclosed the adoption of such rules is frivolous, and that such rules are necessary both to clarify in advance how Section 272 will be applied and because existing rules are not remotely sufficient to check potential BOC abuses of market power -- as Congress found.

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[2] See generally AT&T; CompTel; Excel; Frontier; ITAA; MCI; PUCO; Sprint; TCG; Time Warner.

[3] See, e.g., California PUC, pp. 2-5; NYDPS, pp. 2-5; PUCO, p. 2; but see First Report and Order, ¶¶ 93-97, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (released Aug. 8, 1996) ("First Interconnection Order") (rejecting argument that Section 2(b) of the Communications Act deprives the Commission of jurisdiction over intrastate services under Section 251) .

[4] See generally Ameritech; Bell Atlantic; BellSouth; NYNEX; PacTel; SBC; USTA; U S West.

Part II (pp. 15 - 30) addresses the structural separation rules, non-discrimination rules, and enforcement procedures that the Commission should adopt to implement the applicable provisions of Sections 271 and 272. In particular, it responds to RBOC proposals that would establish massive loopholes in those requirements, or that would render them virtually impossible to enforce.

Part III (pp. 30 - 33) responds to the RBOCs' comments on the joint marketing provisions of the Act. It shows that the RBOCs' claim that the Commission's proposals would deprive them of the ability to engage in permitted joint marketing is simply wrong. At the same time, the scope of permissible joint marketing is defined in part by the structural separation, equal access, and other relevant provisions of the Act, and to the extent the RBOCs argue that any of those provisions are inapplicable to marketing and should not be enforced in that context, that argument should be rejected.

Part IV (pp. 33 - 37) addresses the issue of the proper regulatory classification of BOC interLATA affiliates. It reiterates that while some features of dominant carrier regulation may be dispensable in this context, other such features -- along with the additional requirements established by Section 272 -- are necessary to deter and detect anticompetitive conduct by the BOCs and their affiliates.

I. THE COMMISSION CAN AND SHOULD ADOPT RULES IMPLEMENTING SECTION 272.

There can be no serious dispute that Section 272 fully applies to international services, to interstate and intrastate interLATA services,[5] and to interLATA information

[5] See First Interconnection Order, ¶¶ 93-97.

services,[6] including in-region interLATA electronic publishing.[7] The RBOCs assert, however, that the Commission has no authority under Section 272 to adopt rules that do anything more than "incorporate the statutory language."[8] They contend that Congress designed Section 272

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[6] AT&T's comments (pp. 13-14) explained that an information service is interLATA whenever interLATA transmission or access is a component of the service. Some RBOCs appear to suggest that an information service bundled with interexchange service would not be interLATA if the BOC resold the interexchange service rather than providing that service through its own facilities. See, e.g., Bell Atlantic, pp. A3-A4 ("InterLATA information services are limited to those in which the BOC's own facilities or services carry the information service itself across LATA boundaries"); USTA, p. 14 (no competitive concerns as long as "the BOC does not actually use its own interLATA telecommunications transmission facilities in offering these services"). That is plainly incorrect. An interLATA service is interLATA regardless of whether the service is provided over resold facilities or a carrier's own facilities -- as the Court of Appeals for the D.C. Circuit has held. See United States v. Western Elec. Co., 907 F.2d 160, 163 (D.C. Cir. 1990).

[7] U S West's assertion (p. 13) that "electronic publishing is excluded from Section 272" is incorrect. Section 272(a)(2)(B) requires a BOC to use a separate affiliate to offer any "originating interLATA services" in-region, so § 272(a)(2)(B) requires compliance with § 272's separate affiliate and nondiscrimination requirements for any in-region interLATA electronic publishing service. Section 272(a)(2)(B)(i) specifically provides that this separate affiliate duty applies to the incidental in-region interLATA information service (authorized by section 271(g)(4)) "that permits a customer that is located in one LATA to retrieve stored information from, or file information for storage in, information storage facilities of such company that are located in another LATA." Because the BOCs have previously indicated that electronic publishing, as well as other information services, will include this "interLATA access" as a component (see AT&T, p. 13, n.15), Section 272's requirements will apply to all in-region electronic publishing and other information services that have these characteristics.

U S West's arguments rest on a misunderstanding of the separate provisions of Section 272(a)(2)(C) which requires that BOCs also comply with its separate affiliate and nondiscrimination requirements for interLATA information services generally, except for alarm monitoring and electronic publishing. But because Section 272(a)(2)(B) imposes these requirements for all in-region interLATA information and electronic publishing services, Section 272(a)(2)(C) merely operates to extend the separate affiliate and nondiscrimination requirement to out-of-region interLATA information services that are not electronic publishing or alarm monitoring. In that regard, to the extent an interLATA information service, like interLATA internet access, is excluded from the definition of electronic publishing (see section 274(h)(2)), it likewise is subject to the separate subsidiary requirements under either section 272(a)(2)(B) (if in-region) or section 272(a)(2)(C) (if out-of-region).

[8] See BellSouth, p. 4; see also Bell Atlantic, p. 2; PacTel, p. 2; SBC, p. 20; USTA, p. 3.

to be "self-executing" and, while assigning the Commission responsibility for enforcement, intended to preclude any implementing regulations other than those that replicate Section 272 verbatim.[9] They further contend that, even if implementing regulations were permissible, none are necessary, both because the meaning and proper application of Section 272 are self-evident, and because, in any event, existing regulations are sufficient to prevent any abuses of bottleneck monopolies (which they deny having). These arguments are baseless.

A. The Commission Has The Authority to Adopt Implementing Rules.

The RBOCs contend that the regulations the Commission has proposed are impermissible because they go beyond the bare terms of Section 272, and because the intent of Congress was to impose the minimum restrictions on their activities that the terms of Section 272 could be read to require. They contend that Section 272's safeguards were a "carefully crafted . . . quid pro quo" that Congress established as the condition of their provision of in-region interLATA service under Section 271,[10] and that any Commission rules "expand[ing] th[os]e requirements" would thus unlawfully upset the "balance" struck by Congress.[11]

This argument is wrong in every respect. First, none of the Commission's proposed rules purports to, or would, add to the requirements imposed by Section 272. To the contrary, while there may be disagreements on individual issues, each proposal reflects a reasonable interpretation of the statutory language that would effectuate Section 272's purposes

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[9] See USTA, p. 3.

[10] Id.

[11] See SBC, pp. 2-3.

by mitigating the potential for the competitive abuses to which Section 272 is directed.[12] The Commission has the express duty to enforce the requirements of Section 272,[13] and it is well-established that an agency has the authority to adopt implementing rules when Congress has enacted broad principles for it to administer.[14] Had Congress specifically wished to restrict that authority in this instance -- in particular, had Congress wished to preclude the Commission from adopting any but the most minimalist interpretations of Section 272's requirements -- it could have so provided. It did not.

In that regard, the reliance of USTA (p. 3) and Bell Atlantic (p. 3) on the legislative history of Section 272 as evidence that Congress "intended for Section 272 to be self-executing" is entirely misplaced. A provision in the Senate bill, which was not adopted by the Committee on Conference, would have "require[d] the Commission to implement new section [272] . . . within nine months of the date of enactment of this bill."[15] The elimination of this

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[12] Indeed, in the event the RBOCs are granted permission to provide in-region interLATA services at some future time when they have not yet lost all monopoly or market power, no set of rules, as a practical matter, will actually be able to prevent all or even most such abuses. That is one reason why the rules the Commission adopts should be as strict as possible, so that they at least prevent as many of the more blatant types of abuses that regulation can address.

[13] See 47 U.S.C. §§ 206-208, 271(d)(3) & (6).

[14] See Morton v. Ruiz, 415 U.S. 199, 231 (1974) ("The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress"); Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) (same). Moreover, in addition to the Commission's specific authority to enforce Section 272, Sections 4(i), 201(b), and 303(r) (see 47 U.S.C. §§ 154(i), 201(b), 303(r)) all authorize the Commission to adopt any rules it deems necessary or appropriate to carry out its responsibilities, so long as those rules are not otherwise inconsistent with the Act. See United States v. Storer Broadcasting Co., 351 U.S. 192, 202-3 (1956) (Sections 154(i) and 303(r) give the Commission "general rulemaking power not inconsistent with the Act or law").

[15] See Joint Explanatory Statement of the Comm. of Conference, H.R. Rep. No. 458, 104th Cong. 2d Sess. 151 (1996); S. Rep. No. 23, 104th Cong., 1st Sess. 24 (1995).

proposed statutory time deadline in no way affected the Commission's authority to adopt implementing regulations on its own schedule -- as Section 4(i) (47 U.S.C. § 154(i)) authorizes the Commission to do.

Second, the RBOCs' suggestion that Section 272's requirements are the quid pro quo for in-region interLATA entry is in any event demonstrably incorrect. Section 271 does not permit a BOC application to be approved merely upon a showing that the BOC will comply with Section 272. To the contrary, Section 271 requires that several other prerequisites be satisfied as well, including a finding by the Commission that such approval would be "consistent with the public interest." See Section 271(d)(3)(C). Because the Commission has the authority to deny a Section 271 application on the ground that the BOC's entry would not be in the public interest in the absence of stringent separation and non-discrimination requirements, it obviously has the authority in advance to declare by rule that a BOC will have to comply with such requirements as a condition of approval[16] -- and it would have that authority even if those requirements were not independently authorized by Section 272.

B. Implementing Rules Are Necessary.

The RBOCs also contend that, even if the Commission has the authority to adopt rules implementing Section 272, it should not exercise that authority because such rules are unnecessary. BellSouth asserts (p. 3) that "the statute is clear."[17] PacTel likewise contends (p. 2) that Section 272 contains no "broad guidelines" that would require "the development of detailed regulations." Ameritech, by contrast, concedes (p. 39) that the Commission will be

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[16] See SEC v. Chenery Corp., 332 U.S. 194, 203 (1947) ("the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency").

[17] See also Bell Atlantic, p. 2; SBC, p. 20.

required to "give content" to Section 272's terms, but recommends that it decline to do so by rule and instead await the filing of "individual BOC section 271 applications" to resolve all open questions.

These contentions are insupportable. The purpose of Section 272 is to check any effort by the BOCs to abuse whatever residual market power they possess after they receive interLATA authority under Section 271. The core provisions of Section 272 contain precisely the type of general language -- for example, that the BOC and its affiliate "operate independently" (see Section 272(b)(1)) and that the BOC "may not discriminate" (see Section 272(c)(1)) -- that requires agency rules in order to effectuate the statutory purpose in the best way. And the fact that the RBOCs dispute most of the interpretations of Section 272 set forth by the Commission in the NPRM, as well as those of a majority of the commenters, suggests at a minimum that their understanding of the statute's clear meaning differs substantially from that of others that have studied the matter.

In all events, in light of those many disagreements, all parties would benefit from detailed Commission rules establishing now how Section 272 will be applied. That is especially the case given that, as Ameritech concedes, Commission determinations on these issues are ultimately unavoidable under Sections 271(d)(3) and 271(d)(6). It is well-settled that in order to best serve the goals of predictability, comprehensive agency consideration, and full participation by interested parties, "[t]he function of filling in the interstices of the Act" should be performed through rulemaking rather than adjudication "as much as possible." SEC v. Chenery Corp., 332 U.S. 194, 202 (1947). In light of the inescapable fact that the Commission will have to interpret Section 272 at some point, the most rational and efficient procedure is therefore for it to set forth the requirements of Section 272 in an early and comprehensive

rulemaking rather than in piecemeal adjudications -- especially given the highly compressed time frames in which such adjudications will have to be decided.[18]

The RBOCs also argue that Section 272 regulations governing their activities are unnecessary because present competitive conditions and existing rules are sufficient to prevent them from engaging in any anticompetitive conduct. In particular, they variously claim either that they have no local monopolies to abuse,[19] or that their monopolies cannot be abused because of existing interconnection rules adopted under Section 251,[20] non-structural safeguards,[21] price cap and cost allocation rules,[22] and the putative infeasibility of discrimination.[23]

The short answer to these claims is that Congress found otherwise, and had ample reason for concluding that the existing rules (which were not designed to address potential RBOC

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[18] See 47 U.S.C. 271(d)(3) (90 days); 47 U.S.C. § 271(d)(6) (same). Indeed, even PacTel ultimately concedes (p. 3) that it would "serve the interests of justice for the Commission to indicate in advance -- whether by rule or otherwise -- how it interprets any ambiguous requirements in § 272 so that the BOCs may be advised of what is necessary to comply."

[19] See Ameritech, pp. 13-17.

[20] See Ameritech, pp. 14-15; PacTel, pp. 53, 55; USTA, p. 38; U S West, p. 48.

[21] See, e.g., SBC, p. 17; USTA, p. 4.

[22] See Bell Atlantic, pp. 16-17; BellSouth, pp. 52-53; NYNEX, pp. 55-56; SBC, p. 14; PacTel, pp. 55-56; USTA, pp. 45-47; U S West, p. 50.

[23] See Bell Atlantic, pp. 17-18; NYNEX, pp. 56-57; PacTel, pp. 58-61; USTA, pp. 47-50. The RBOCs also claim that their behavior in those competitive markets which they have been permitted to enter demonstrates that they would not or could not engage in anticompetitive conduct if permitted to provide in-region interLATA services. See, e.g., NYNEX, p. 56. These claims are fanciful. As AT&T has elsewhere demonstrated, the RBOCs have compiled a substantial record of anticompetitive conduct in markets where the opportunities for such misconduct, and the potential rewards, are not nearly as great as in the one they now seek to enter. See AT&T's Opposition to the Four RBOCs' Motion to Vacate the Decree, pp. 148-158 & Affidavit of B. Douglas Bernheim and Robert D. Willig, pp. 97-129, United States v. Western Elec. Co., Civil Action No. 82-0192 (D.D.C. filed Dec. 7, 1994).

entry into the interexchange market) would be inadequate and that new and stricter ones were required. In this regard, any suggestion that the BOCs will by then necessarily have lost their market power is wrong. As the Commission notes (¶ 7), in the areas where BOCs provide service, they today control 99.5% of the local market by revenues. And depending on how the Commission applies the "public interest" standard under Section 271(d)(3)(C), it is possible that a BOC will be permitted to provide in-region interLATA service in a state even where there is no facilities-based alternative for up to half of its customers (see Section 271(c)(1)(A)). Further, a BOC conceivably could maintain an absolute access monopoly in adjacent states.

Congress required structural separation to prevent abuses of whatever residual market power the BOCs may then possess. It recognized that non-structural safeguards, price caps and accounting rules cannot realistically prevent cost misallocations, and it imposed broad non-discrimination requirements because it recognized that the BOCs would have both the incentive and the ability to engage in subtle, serious, and competitively harmful acts of discrimination. Indeed, Congress further concluded that even the presence of facilities-based competition and the imposition of these additional safeguards would not be sufficient to warrant permitting the BOCs to provide in-region interLATA service, because even when those preconditions are met it still required that the BOC make a separate "public interest" showing before a Section 271 application may be approved. The RBOCs' suggestion that existing rules alone could be sufficient to protect competition and consumers is thus squarely rejected by the Act.

In that regard, the RBOCs' repeated reliance on the Commission's recent § 251 local interconnection rules is a red herring. Those rules do not create the competitive alternative access facilities that can alone prevent discrimination in the interface between local and long

distance services. To be sure, the adoption of interconnection agreements that fully implement these requirements is one precondition that has to be met before a BOC can obtain interLATA authority, and the Commission's interconnection rules are an essential predicate to enabling competing local exchange carriers to enter the market. However, Congress also required as preconditions to a BOC's interLATA entry that it face facilities-based competition and comply with the structural separation and non-discrimination requirements of Section 272, because the interconnection rules themselves cannot prevent the BOCs from engaging in discrimination that enables them to offer superior long-distance service that has the result of (1) creating illicit advantages in winning customers that wish to obtain local and long-distance services from a single provider, or (2) impairing the ability of interexchange carriers to obtain the interexchange business of customers that are using the BOC (or its facilities) for local exchange service.

The other regulations cited by the RBOCs are likewise insufficient in this context. With respect to non-structural safeguards, it is irrelevant (see SBC, pp. 16-17) that the Commission has found such rules adequate in other, far more limited areas like enhanced services. Courts have found that the Commission's non-structural safeguards were not designed for, and would not be effective in regulating, BOC entry into the interexchange market,[24] and that is why Congress required full structural separation instead.[25] Indeed, even in those areas to which non-structural safeguards have been applied, the BOCs have had little incentive to

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[24] See United States v. Western Elec. Co., 900 F.2d 283, 301 (D.C. Cir. 1990); United States v. Western Elec. Co., 673 F. Supp. 525, 569-70 (D.D.C. 1987).

[25] See USTA, p. 4 (conceding that Congress has "chosen to go beyond non-structural safeguards" and has mandated structural separation).

comply rigorously, and anticompetitive behavior has often remained undiscovered until years after the fact -- if ever.[26]

Nor do price cap rules deprive the BOCs of the incentive to misallocate costs or the ability to engage in price squeezes. As AT&T has shown in its initial comments and elsewhere,[27] the caps under both state and federal price cap regimes continue to be related to recorded costs and to depend upon productivity factors that are periodically reset, so the incentive to misallocate remains.[28] The deficiencies inherent in any system of cost allocations

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[26] For example, not until March 1995 did the Commission issue show cause orders alleging that a number of BOCs had misallocated costs, in violation of the Commission's rules, during the 1988-1989 period -- more than six years earlier. See, e.g., Order to Show Cause, Ameritech Tel. Operating Cos., 10 FCC Rcd. 5606 (1995); Order to Show Cause, Bell Atlantic Tel. Cos., 10 FCC Rcd. 5099 (1995); Order to Show Cause, Southwestern Bell Tel. Co., 10 FCC Rcd. 5306 (1995).

Similarly, in the BellSouth MemoryCall proceeding, although the Georgia PSC found that BellSouth may have engaged in cross-subsidization, it was unable to make a final determination of the issue because Southern Bell had refused to provide any cost data until the last day of the hearings (despite previous PSC orders to do so), and the cost data that it did supply was totally inadequate. Id., pp. 41-42. The PSC concluded that the record "shows that SBT will not even make a cursory attempt to curb potential and actual abuses of its monopoly power unless and until regulatory intervention is threatened or occurs." Order, p. 39, Investigation into Southern Bell Tel. and Tel. Co.'s Provision of MemoryCall℠ Serv., Docket No. 4000-U (Georgia PSC decided May 21, 1991). See id. 39, 41-42. See also PUCO, pp. 4-5 (describing 1993 PUCO proceeding involving allegations of similar anticompetitive conduct by Ameritech).

[27] See AT&T p. 64 n.56; AT&T's Opposition to the Four RBOCs' Motion to Vacate the Decree, pp. 71-78 & Affidavit of B. Douglas Bernheim and Robert D. Willig, pp. 82-86, United States v. Western Elec. Co., Civil Action No. 82-0192 (D.D.C. filed Dec. 7, 1994).

[28] Indeed, because the BOCs will now be required by Section 251 to charge cost-based rates for unbundled network elements, they will have additional incentives to mischaracterize costs associated with their competitive services as costs associated with their non-competitive services. And to the extent the new regulations are successful in preventing the BOCs from obtaining monopoly rents through such mischaracterizations, their incentives to obtain those rents through acts of discrimination will be even greater.

mean that the ability to misallocate remains as well.[29] And because the price caps are then consistently set at levels many times higher than the BOCs' true economic costs of providing access, they do not prevent -- indeed, they permit -- a variety of forms of price squeezes.[30]

Finally, the NPRM properly rejects (¶ 139) any suggestion that the BOCs will not have powerful incentives to engage in discriminatory conduct, or that such conduct can be effectively prevented through regulatory mechanisms. The interface between interexchange and exchange carriers requires extraordinary cooperation to be maintained and enhanced, and no set of regulations or enforcement mechanisms can effectively compel a BOC to "go the extra mile" and provide the same degree of cooperation in that regard to its competitors as to itself.[31]

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[29] Among other things, regulatory costing systems depend on accurate categorization of individual transactions when they are entered into the relevant account and sub-account ledgers. Of necessity, the accounting rules and cost allocation manuals leave the initial cost categorization to the RBOC's judgment. Given that RBOCs record thousands of such transactions a day, the most scrupulous enforcement of the rules by this Commission and state commissions cannot realistically prevent most cost shifting. The better approach -- adopted by the Act -- is to require complete structural separation so as to eliminate at the outset, to the extent feasible, most joint and common costs altogether.

[30] For example, as two of the RBOCs themselves have noted in a different context, while an affiliate may be required by a regulation to record an access price increase as if it were a genuine cost, that increase remains "merely an intracorporate accounting entry having no effect on the combined [companies'] financial position." See Comments of Bell Atlantic Corp. and NYNEX Corp. on Proposed Final Judgment, p. 5, United States v. AT&T Corp. and McCaw Cellular Communications, Inc., No. 94-CV-01555 (D.D.C. filed Oct. 25, 1994).

[31] The RBOCs suggest (Ameritech, pp. 24-25; USTA, pp. 47-51) that increased automation in the provisioning of standardized access will make discrimination more difficult. But many of the systems that they describe do not now exist and all of them would, in any event, require programming that prioritizes access requests and determines the order in which such requests will be acted upon, and can be used in that and other ways to accomplish subtle and effective acts of discrimination. More fundamentally, such systems are absolutely irrelevant to situations in which interexchange carriers must request new access arrangements to accommodate new, cutting-edge interexchange services they plan to offer, where the incentive of BOC competitors to discriminate will be greatest and where no meaningful benchmarks to measure performance exist.

Contrary to the RBOCs' misstatements (see e.g., USTA, p. 50 n.22), therefore, interexchange carriers cannot effectively monitor and detect whether such discrimination is taking place -- and even when they do, except where such acts are exceptionally flagrant, they will generally find it impossible to quantify and prove its existence in legal or administrative proceedings.[32]

These practical limitations mean that any set of rules will inherently be unable to prevent all or even most forms of misconduct as long as the BOCs retain market power. The stricter the rules, however, the more likely they will be to prevent at least the most blatant forms of misconduct. Conversely, the suggestion that existing rules alone can be relied upon to do the job so thoroughly and effectively that no further regulation is required defies both the Act and years of experience.

II. THE COMMISSION SHOULD ADOPT REGULATIONS THAT FULLY IMPLEMENT SECTION 272'S STRICT STRUCTURAL SEPARATION AND NON-DISCRIMINATION REQUIREMENTS.

A. Structural Separation

With the exception of the RBOCs, the commenters generally agree that the Commission should adopt comprehensive regulations that fully implement the structural

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[32] USTA thus completely misses the point in contending (p. 32 n.13) that because discrimination would create differences in performance between the BOC and its competitors that customers would notice, competitors would also notice and could allegedly complain to regulators. The largest hurdle for competitors is not noticing the difference, but proving the discrimination, for the BOCs would invariably claim that any difference is attributable to the efficiencies of integration. USTA's reliance (id.) on an anomolous 1987 statement by the Meese Justice Department to support its argument on this point is particularly misplaced, because the Justice Department consistently took the contrary position both before and after that statement. See Competitive Impact Statement, pp. 3-4, 15-16, United States v. American Tel. & Tel. Co., Civil Action No. 74-1698 (D.D.C. filed Feb. 10, 1982); Memorandum of the United States in Support of its Motion for a Modification of the Decree to Permit a Limited Trial of Interexchange Service by Ameritech, pp. 8-14, 36-45, United States v. American Tel. & Tel. Co., Civil Action No. 74-1698 (D.D.C. filed May 1, 1995).

separation requirements of Section 272.[33] These comments recognize that such regulations are essential to effectuating the statutory objective of prohibiting integrated provision of exchange and interexchange operations by the BOCs and their affiliates, because such integration would be inherently discriminatory and would permit claims of joint and common costs that would be permit long distance costs to be misallocated to local services.[34]

Full implementation of the structural separation requirements is particularly necessary because the comments suggest that the BOCs fully intend to evade the requirements by every means possible. In particular, the RBOCs' comments demonstrate that they intend to arrange for the provision of services to a BOC and its interexchange affiliate by a third entity in its corporate family, under the theory that the separation requirements are restricted to dealings between a BOC and its Section 272 affiliate. Unless the Commission promulgates regulations that preclude such conduct, the structural separation requirements will have little effect.

1. The Commission should implement Section 272(b)(1)'s "operate independently" requirement by imposing the safeguards of Computer II.

Several BOCs contend that the "operate independently" requirement of Section 272(b)(1) has no independent meaning,[35] or at most constitutes a "general, qualitative

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[33] See ALTS, p. 1; CompTel, p. 1; Excel, p. 2; Frontier, p. 2; IIA, pp. 2-4; MCI, p.2; New Jersey Division of Ratepayer Advocate, pp. 2-3; NYDPS, pp. 1-2, 7-8; PUCO, p. 8; Sprint, p. 5; TIA, pp. 4-7; TCG, pp. 1-2, 10, 19, 23; Time Warner, pp. 2, 14-15. See also NCTA, pp. 1-2.

[34] See, e.g., CompTel, pp. 14-15; Frontier, pp. 2-5; IDCMA, pp. 1-6; IIA, pp.1-3; ITAA, pp. 2-4, 16-20; NCTA, pp. 10-11; New Jersey Division of Ratepayer Advocate, pp. 2-3; Sprint, pp. 19-20; TIA, pp. 4-8, 20; TCG, pp. 8-13, 18-19; Time Warner, pp. 11-20.

[35] See, e.g., Bell Atlantic, p. 4; BellSouth, p. 30; USTA, p. 19.

standard," "summary language," or a "gloss" that requires no particular implementing regulations.[36] However, as numerous commenters point out,[37] the Commission is plainly correct in concluding that because Congress imposed the "operate independently" requirement of § 272(b)(1) as a separate requirement in addition to the four "specific" requirements in Section 272(b)(2)-(5), it must be interpreted as imposing something additional. Specifically, it should be applied to effectuate whatever additional requirements are necessary to ensure that the BOC and its affiliate operate as if they are truly independent companies -- which, as these commenters conclude, can best be accomplished through imposition of some or all of the Computer II safeguards.[38]

As AT&T explained in its Comments (pp. 20-21), those safeguards should include a ban on the ownership or operation by the BOC affiliate of exchange facilities, or the provision of exchange services through any means other than resale under Section 251(c)(4). As the Wisconsin PSC staff has found, the ownership or operation by the BOC affiliate of exchange facilities would create a strong incentive for the BOC to place exchange innovations and other quality improvements with the affiliate, so that competitors dependent on the BOC facilities "'will find them increasingly obsolete.'"[39]

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[36] See Ameritech, p. 38; PacTel, p. 20; U S West, p. 29.

[37] See CompTel, pp. 13-14; Excel, pp. 4-5; Frontier, p. 4; IDCMA, p. 2; ITAA, pp. 16-17; MCI, p 23; Sprint, pp. 19-20; TIA, pp. 21-22; Time Warner, pp. 16-19.

[38] See, e.g.,Excel, pp. 6-8; IDCMA, pp. 4-6; ITAA, pp. 17-19; MCI, pp. 23-27; PUCO, p. 9; Sprint, pp. 21-23; TIA, p. 22; TCG, p. 19; Time Warner, pp. 17-18.

[39] See TCG, p. 5 (quoting Staff Comments, p. 8, Application of Ameritech Communications of Wisconsin, Inc. for Certification as a Telecommunications Carrier, 139 NC-100 (June 5, 1996)).

The RBOCs' argument that such a rule is precluded because it was not specifically included in Section 272(b) (see, e.g. USTA, p. 18) is frivolous. Congress did not preclude such a rule. Instead, it established five separations requirements, one of which is framed in exceptionally broad terms. Those terms give the Commission the right and the duty to impose such a rule if it is required to assure that the exchange and interexchange businesses "operate independently" -- as it is -- or if the Commission determines that it would effectuate the purposes of Section 272 -- as it would.[40]

2. The RBOCs may not evade the requirements of Section 272(b) by integrating the BOC's operations with the affiliate's operations in a second affiliate.

In perhaps the most significant issue to surface in these comments, the RBOCs have made clear that they intend a patently improper end-run around the separation requirements of Section 272. Specifically, the RBOCs assert that Section 272(b)'s structural separation requirements apply only between the BOC and its Section 272(a) affiliate, and not between the BOC (or its Section 272(a) affiliate) and other affiliates. Therefore, they argue, the BOC and

[40] For the same reasons, the RBOCs' various arguments that the Commission is foreclosed from adopting particular separations requirements either because they were not regarded as necessary to establish operational independence under Computer II, see, e.g., Ameritech, pp. 44-45, Bell Atlantic, pp. 3-4, BellSouth, pp. 27, 30, or because they are separately included in Section 274 but not in Section 272, see, e.g., BellSouth, p. 30, are particularly misguided. Congress charged the Commission with developing whatever requirements, in addition to the specific requirements established by Sections 272(b)(2-5), are necessary to ensure that the BOC and its affiliate "operate independently" under Section 272(b)(1). The fact that a requirement is not specifically mandated by Sections 272(b)(2-5) (whether or not it was mandated for enhanced services by Computer II or is mandated for electronic publishing by Section 274) does not mean that the Commission is prohibited from adopting it under Section 272(b)(1) if it will effectuate that section's language and purpose. That is particularly so because the phrase "operate independently" has a different location and function in § 272 than it does in § 274.

its Section 272 affiliate are permitted to each obtain any and all services provided on a centralized basis by their holding company or another affiliate.[41]

If the RBOCs' position on this point is adopted by the Commission, the RBOCs will be able to engage in a wholesale evasion of Section 272 by achieving the precise integration of their exchange and interexchange operations that Sections 272(a) and 272(b) prohibit. Indeed, their purportedly separate section 272(c) affiliates could be maintained as virtual shells with skeleton crews of employees, while all significant functions are discharged in concert with the BOC by outsourcing them to the additional affiliate -- thus enabling the personnel of the BOC to become fully involved in the operation, marketing, planning, or other activities of the affiliate, and vice versa.

The Commission should thus make explicit that a corporate family member, whether a holding company or another affiliate, may not perform services for the BOC and the interexchange affiliate, or for the interexchange affiliate in concert with the BOC in a way that the interexchange affiliate and the BOC could not do directly. Such an arrangement would violate Section 272(b)(3), because the personnel in the third entity would be de facto employees of the BOC and its affiliate. Moreover, such a practice would also violate Section 272(b)(1), because an affiliate does not "operate independently" when a third entity used or established by the BOC is providing the same services to both the BOC and the affiliate, or is otherwise working on behalf of one in concert with the other.

For largely similar reasons, the Commission should reject the RBOCs' claims that Section 272 would permit the sharing of in-house services or the joint outsourcing of services

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[41] See Ameritech, pp. 39-40; Bell Atlantic, pp. 4-5, 7-8; BellSouth, p. 31; NYNEX, pp. 23-33; PacTel, pp. 17-18, 23; SBC, p. 7; USTA, p. 21.

to a third entity.[42] The sharing of in-house services is inherently inconsistent with the statutory requirement of separate personnel.[43] Indeed, any sharing of services, whether in-house or out-sourced, would increase the amount of joint and common costs between the BOC and its affiliate, thereby creating the opportunity for the misallocation of costs that the requirements of separate personnel and operational independence were intended to reduce.[44]

The sharing of product design, development, and planning would raise particular concerns because it would constitute an integration of the core functions of the two entities. However, while the sharing of some purely administrative services (such as pensions) presents fewer potential difficulties, a complete ban on the sharing of services is the cleanest solution. It poses the fewest risks to competition; it is the easiest to police; it is most consistent with the

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[42] See Ameritech, pp. 40-43; Bell Atlantic, pp. 6-8; BellSouth, pp. 30-31; NYNEX, pp. 23-25; PacTel, pp. 21-23; U S West, pp. 22-25; USTA, pp. 20-22.

[43] CompTel, pp. 18-19; ITAA, p. 19; MCI, pp. 27-28; Sprint, p. 26; TIA, p. 27; TCG, p. 20; Time Warner, pp. 18-19. The fact that in-house sharing of administrative services was permitted under Computer II (see PacTel, p. 22) is not dispositive here. Section 272(b)(3) forecloses sharing by requiring that all personnel of the BOC ("officers, directors, and employees") -- not merely those engaged in "operating, marketing, installation, and maintenance," see 47 C.F.R. § 64.702(c)(2) -- be separate from those of the BOC.

[44] Contrary to Ameritech's argument (p. 41), the arms-length requirement of Section 272(b)(5) and the nondiscrimination provisions of Section 272(c) are not rendered meaningless if sharing of administrative services is unlawful under Section 272(b)(3). Both Section 272(b)(5) and Section 272(c)(1) encompass a far wider range of activities than the sharing of services; Section 272(b)(5) covers all transactions between a BOC and its affiliate, and Section 272(c)(1) encompasses the provision or procurement of goods, facilities, information, and services by a BOC for an affiliate. These statutes are plainly directed not at in-house administrative services, but at services, such as interexchange access, that the BOC would reasonably be expected to provide to the competitors of the affiliate as well as to the affiliate itself.